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Supreme Court of the United States.

OCTOBER TERM, 1951.

No. [redacted] . 99

MARION A. BURT BECK,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Second Circuit entered in this case.

Opinions Below.

The findings of fact and opinion of the Tax Court (29a-76a)* are reported at 15 T. C. 642. The *per curiam* affirmance of the Court of Appeals on the opinion below (409a-410a) is reported at 194 F. 2d 537.

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* All undesignated references are to pages of the Record. By stipulation, the major part of the Exhibits were not printed, but a certified copy of these has been filed.

Jurisdiction.

The judgment of the Court of Appeals was entered on March 3, 1952 (411a). The jurisdiction of this Court is invoked under §240A of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

1. What weight, if any, should be given to the valuation placed on petitioner's iron ore lands (inherited from her father) in the Federal estate tax proceedings of her father's estate (in which she took no part) as evidence against her in income tax controversies in later years in which her depletion allowance partly depended upon the value of said lands when she acquired them?

2. Under the statutory authority (as amplified by the Regulations) to revise the tonnage estimates for depletion purposes "in any case in which it is ascertained either by the taxpayer or the Commissioner as the result of operations or development work prior to the close of the taxable year" that the original estimate was too small, was it proper for the Commissioner, on the basis of information acquired by him in 1943, to revise petitioner's depletion allowance for the years 1938 to 1941, inclusive, when the petitioner had no such information and made no such ascertainment during the taxable years?

3. Was petitioner taxable, as held by the Commissioner and the Courts below, on that portion of the iron ore royalties which was irrevocably assigned

to a separate trust by the same compromise agreement under which she acquired her interest in the lands?

4. The petitioner gave to charity in 1939, 1940 and 1941 interests in a trust which she believed she owned, on the basis of the best legal advice obtainable. Should her charitable deductions be retroactively disallowed, on the basis of a five to two decision of the Michigan Supreme Court in 1947 that she did not own such an interest, despite a Michigan statute enacted in 1949 which upheld her ownership?

Statutes and Regulations Involved.

Internal Revenue Code:

Sec. 23. *Deductions From Gross Income.* * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

Sec. 113. *Adjusted Basis for Determining Gain or Loss.* * * *

(a) (5) *Property Transmitted at Death.*—If the property was acquired by bequest, devise or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition.

Sec. 114. *Basis for Depreciation and Depletion.* * * *

(b) *Basis for Depletion.*—

(1) *General Rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property * * *.

Treasury Regulations 103:

Sec. 19.23(m)-8. *Revaluation of Mineral Deposits Not Allowed.*—No revaluation of a property whose value as of any specific date has been determined and approved will be made or allowed during the continuance of the ownership under which the value was so determined and approved, except in the case of * * * misrepresentation or fraud or gross error as to any facts known on the date as of which the valuation was made. Revaluation on account of misrepresentation or

fraud or such gross error will be made only with the written approval of the Commissioner. * * *

Sec. 19.23(m)-9. *Determination of Mineral Contents of Mines and of Oil or Gas Wells.*—If it is necessary to estimate or determine with respect to any property as of any specific date the total recoverable units (tons, pounds, ounces, barrels, thousands of cubic feet, or other measure) of mineral products reasonably known, or on good evidence believed, to have existed in the ground as of that date, the estimate or determination must be made according to the method current in the industry and in the light of the most accurate and reliable information obtainable. In the selection of a unit of estimate, preference shall be given to the principal unit (or units) paid for in the product marketed. The estimate of the recoverable units of the mineral products in the property for the purposes of valuation and depletion shall include as to both quantity and grade—

(a) The ores and minerals "in sight," "blocked out," "developed," or "assured," in the usual or conventional meaning of these terms with respect to the type of the deposit, and

(b) "Probable" or "prospective" ores and minerals (in the corresponding sense), that is, ores and minerals that are believed to exist on the basis of good evidence although not actually known to occur on the basis of existing development; but "probable" or "prospective" ores and minerals may be estimated (1) as to quantity, only in case they are extensions of known deposits or are new bodies or masses whose exist-

ence is indicated by geological or other evidence to a high degree of probability, and (2) as to grade, only as accords with the best indications available as to richness.

If the number of recoverable units of mineral in the property has been previously estimated for the prior year or years, and if there has been no known change in the facts upon which the prior estimate was based, the number of recoverable units of mineral in the property as of the taxable year will be the number remaining from the prior estimate, but in any case in which it is ascertained either by the taxpayer or the Commissioner as the result of operations or development work prior to the close of the taxable year that the remaining recoverable mineral units are materially greater or less than the number remaining from the prior estimate, the estimate of the remaining recoverable units shall be revised and the annual depletion allowance with respect to the property for the taxable year and for subsequent taxable years will be based upon the revised estimate unless a change in the facts requires another revision. Such revised estimate will not, however, affect the basis for depletion.

Sec. 19.113(a)(5). *Basis of Property Acquired by Bequest, Devise or Inheritance.*

(b) *Basis* * * *

(1) *General Rule.*—* * * the basis of property acquired from a decedent by will or under the law governing the descent and distribution of property of decedents is the fair market value at the time of such acquisition. * * * the time

of the acquisition of such property is the death of the decedent. * * *

(c) *Fair Market Value.*—For the purposes of this section, the value of property as of the date of death of the decedent as appraised for the purpose of the Federal estate tax * * * shall be deemed to be its fair market value at the time of acquisition.

Statement.

The taxpayer, a resident of Millbrook, New York, was the daughter of Wellington R. Burt of Saginaw, Michigan, who died March 2, 1919 leaving a large estate consisting principally of stocks and bonds, and valuable iron ore lands on the Mesabi Range in the State of Minnesota, under lease to two subsidiaries of the United States Steel Corporation. In his last will Burt left his residuary estate in trust, the bulk of the income of which was to be accumulated for nearly one hundred years before final distribution to his "legal heirs."

The taxpayer was one of the legal heirs of her father.* She and her co-heirs contested the will. The contest was settled by a compromise agreement which provided that the will, as modified by the compromise agreement, should be probated and carried into effect (33a).

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* The Tax Court was in error in stating (p. 71a) that the later decision in *Hays* v. *Hays*, 317 Mich. 370, in some way vitiated her status as heir; that decision merely held that the phrase "legal heirs" as used in Burt's will referred to the date of distribution of the trust.

Under the compromise agreement, the heirs received $720,000 in cash, and ultimate ownership in all the Minnesota iron ore lands, subject, however, to the setting up of a separate trust out of an agreed portion of the lease royalties, this portion to be substantially equal to the amount of estate and inheritance taxes apportionable to the value of the property received by the heirs under the will as modified. The terms of the separate trust as to income were entirely different from those in the trust established in Burt's original will, for under the separate trust the income became distributable currently to the heirs or their issue as soon as the payment of the agreed portion of royalties to the separate trust was completed (125a, 126a).

The Depletion Issues (I and II).

The lands in question were leased to Lake Superior Consolidated Iron Mines, a wholly-owned United States Steel Corporation subsidiary. The original lease extended for fifty years from January 1, 1900 and provided for a royalty of twenty-five cents per ton on all ore shipped, regardless of the grade of ore, and a minimum annual payment of $50,000. Burt's executors in their estate tax return valued Burt's interest in the lands subject to the lease at $5,195,479, based on an estimate of 54,012,682 tons of ore. By using a more conservative Hoskold formula, but not changing the tonnage estimate, the Treasury increased the valuation to $5,497,576.43 (47a; Ex. 1-A).

The tonnage estimate made by the executors of Burt's will (petitioner was not one of them) was based on the lessee's annual report to the Minnesota Tax Commission. As the Tax Court found, the pri-

mary purpose of the lessee's annual estimate of ore on the leased lands was to fix the basis for its own State *ad valorem* tax and its estimate included only proven ore (48a),—not probable or possible ore, as required by the Regulations, *supra*. Furthermore, respondent's expert Anderson admitted that the *tax* estimate did not include 11,642,273 tons of "low-grade" ore (which was separately estimated by the lessee) and a large amount of "paint-rock" ore, because these ores, containing an iron content of less than 55%, were not taxed by the State (344a, 356a, 357a). All such ore having an iron content of over 49% was merchantable ore under the Burt lease, according to the undisputed evidence of petitioner's expert Millman and the lessee's contemporary drill sheets, and was of the same value to the lessors—25 cents a ton—as the highest grade ore (Ex. 24; 195a-197a, 235a-244a, 308a, 356a, 357a). At least the 11,642,273 tons of low-grade ore was included by Oliver in its own estimate in 1919 (357a); in 1923, when this low-grade ore was first reported to the Minnesota Tax Commission it amounted to 10,773,015 tons (Ex. 31, p. 2, col. 5), showing that at least 869,258 tons of low-grade ore were shipped in the 1919-1923 period, out of total shipments for this four-year period of 3,367,793 tons (48a).

The value of the lessee's interest in the lease on March 1, 1913, as finally determined by the respondent in or about 1923 in settling the taxes of the United States Steel Corporation, was $19,629,199.26 (53a). In fixing the fair market value of the Steel Corporation's properties and all other iron mining properties in Minnesota as of March 1, 1913, the Treasury Department did not use the March 1, 1913 tonnage estimates of the State tax authorities, but used the 1920

tonnage estimates (less intervening shipments), the most recent available; this produced a reasonable estimate of developed and probable ore, according to respondent's expert Grimes, making a total tonnage about 25% in excess of that based on the March 1, 1913 State tax estimate of the lessee (395a, 401a-402a).

On January 1, 1926, the lessors and lessee amended the lease by extending it for 30 years, to January 1, 1980; providing for a minimum quarterly royalty payment at the rate of $687,500 a year through 1949 (instead of $50,000), involving payment for 66 million tons of ore; increasing the royalty rate to 50 cents a ton but reducing the annual minimum to $200,000, from 1950 to 1980; and providing an immediate payment to the lessors of $300,000, which was applied to reduce the minimum royalty at the rate of $15,000 a year beginning January 1, 1930 (Ex. 5-E; 142a-156a). The lessee then knew, as respondent inferentially conceded at pages 31-32 and 35 of his brief in the Court of Appeals, that there were at least 66 million tons of ore on the lease, although its contemporary report to the Minnesota Tax Commission showed only 54 million tons.

There was no substantial difference in any of the conditions affecting the value of the lessor's interest between March 2, 1919 and January 1, 1926, except the shipments of ore during that period, which amounted to 5,369,604 tons (Exs. 34, 35 and Z): there was substantially no new drilling or development work (297a); there was no change in mining methods (219a); the steel industry in general, and the United States Steel Corporation in particular, were prosperous on both dates; the Steel Corporation was indeed considerably more prosperous on March 2,

1919 than on January 1, 1926, from the standpoint of net earnings, dividend payments and unfilled orders on hand (Ex. 35; 173a-174a); the contemporary shipments of ore from the Mesabi Range were about the same on the two dates (Ex. 32).

The 1926 extension agreement, which was substantially equivalent to a sale of the land in an arm's length transaction between a willing buyer and a willing seller, and which could besides have been reasonably anticipated on March 2, 1919 (54a), was the best evidence of the fair market value of the lessor's interest on the latter date, and established a fair market value as of March 2, 1919 of over $10,000,000 (Ex. 34, revised per 229a, 303a).

The only factual basis for the findings of the Courts below as to the fair market value of the ore lands on the basic date, or the tonnage on hand at that date or on hand (for purpose of diluting the depletion allowance) on December 31, 1938-1941, was the lessee's tonnage estimates for the respective dates submitted to and accepted by the Minnesota Tax Commission. The lessee knew on January 1, 1926, that the tonnage in sight was nearly 12 million tons, or 22%, in excess of its contemporary tax estimate; the 1919 tax estimate was equally incomplete (357a); and there is no evidence that the 1938-41 tax estimates were any better.

Apart from their incompleteness and inaccuracy, these estimates were never brought to petitioner's attention until long after the taxable years in question, and she never ascertained *as a result of operations or development work* between March 2, 1919 and December 31, 1941 that the ore reserves were greater

than the 1919 State tax estimate. The Commissioner first purported to ascertain this fact in his 90-day letter in 1948 (11a). It was in 1943 that he first proposed to reduce petitioner's 1938-41 depletion allowances (55a). From 1919 to 1937, petitioner was allowed depletion at the uniform rate of $.016967 per ton (one-sixth of $.1018). For the years 1938-1941, this allowance was progressively reduced from $.0096048 in 1938 to $.0070086 in 1941, on the basis of the steadily increasing State property tax assessments (47a, 51a).

The Royalties Irrevocably Assigned to a Separate Trust (III).

The will compromise agreement (Ex. 3-C; 112a) provided that

> "all the estate of said WELLINGTON R. BURT, deceased, shall be disposed of and managed in accordance with the provisions of said Will, as modified by this agreement, with the same effect as if said will of WELLINGTON R. BURT, deceased, had contained provisions having the legal effect of so modifying it, and in the final order distributing said estate, the property belonging thereto shall be assigned and distributed as if said will had been so modified."

The will, as so modified, was accordingly admitted to probate in Michigan and Minnesota.

The compromise provided that petitioner and her co-heirs should be charged with the Federal and State estate and inheritance taxes allocable to their share; that all taxes on the Minnesota property for 1919

and before should be "paid" out of the remainder of the estate, and that such taxes for subsequent years should be "paid" by the heirs.

Sec. 5, Ex. 3-C (116a-117a) further provided that the taxes

> "so chargeable * * * shall in the first instance, be paid by the said party of the third part, executor or trustee, from the funds of the estate other than the money and property going to parties of the first part under Section 3 hereof, and shall be repaid in the way and manner prescribed in Section 6 of this Agreement in twenty-six equal annual payments—the first payment to be made five years from the date of the final order or decree hereinbefore mentioned—with interest upon the unpaid portions of the principal payable semi-annually at the rate of four per cent per annum from July 1, 1920."

Sec. 6 (117a) provided that to secure the "payment" to the executor-trustee, the latter and its co-trustee Morley were "vested with the legal title in trust to all of the estate's Minnesota leased lands;" they were directed to pay over the first $100,000 of annual net proceeds to the heirs; from the further proceeds to retain and accumulate sufficient to cover "the interest and any matured installments of indebtedness described * * * in Section 5 of this Agreement" for the purposes described in Section 7, and to pay over the balance to the heirs. All interest of the executor-trustee was to terminate January 1, 1975 in all events (122a).

Sec. 7 (125a-126a) provided that the retained proceeds be accumulated in a separate trust "until the payment of the last installment of indebtedness," and that thereafter the income of said separate trust be paid *per stirpes* to the testator's descendants, and that the separate trust should terminate at the same time and its principal be distributed in the same manner as the trust of personalty under the will (the income of which was accumulated in its entirety till the date of distribution of the principal).

Sec. 6 also provided (123a) that the heirs execute an instrument in the form annexed thereto (Ex. 4-D; 130a-142a), which stated:

> (132a) "This bond is issued under and secured by a certain Indenture dated 1920, executed by the Obligors to the Trustee, which said Indenture is duly recorded in the Office of the Register of Deeds for St. Louis County, in the State of Minnesota. Reference is hereby made to said Indenture and to said Agreement for a description of the property pledged, the nature and extent of the security, the rights and obligations of the Obligors and Obligee herein, *and the terms, limitations and conditions upon and subject to which this bond is issued, and is to be paid.*" (Italics supplied.)
>
> * * * *
>
> (134a) "2. *The principal and interest of said bond shall be payable only from the royalties received from the lease of said above described lands, or from the proceeds of the sale of said lands and the ore therein, if a sale thereof is made as hereinafter and in said Agreement set*

forth, and the obligation of the Obligors with respect to said bond, or to the indebtedness (both principal and interest) evidenced by it is to be limited to said royalties or to the proceeds of the sale of said lands and the ore therein, in the event of a sale thereof." (Italics supplied.)

Six years later, after the large lease was amended (Ex. 5-E; 142a), the heirs and the Second National Bank of Saginaw agreed to readjust slightly the provisions for the establishment of said separate trust, to conform to the lease amendment. Said agreement (Ex. 6-F; 157a) neither contemplated nor created any personal liability on the heir's part for the "repayment" of the so-called "indebtedness," which continued to be merely an irrevocable assignment of the specified amount of payments from the Minnesota properties.

The Disallowed Charitable Contributions (IV).

The Tax Court findings on this issue are substantially correct (38a-43a). The petitioner, believing that she owned a one-sixth interest in the trust of personalty under her father's will (72a), donated parts of it to charity annually, beginning in 1939. In 1941, she and her co-heirs sued to dissolve the trust. In 1947, the Michigan Supreme Court held by a vote of five judges to two that the words "legal heirs" in the will did not have their customary meaning, but referred to the persons who would be the testator's legal heirs if he died when the trust terminates in the next century.

Chapter 227 of the 1949 Public Laws of Michigan, effective September 13, 1949, provided (with the

evident intent among other things of nullifying the above decision):

> "If in either of the cases mentioned in the preceding section" (respecting accumulations of income of real or personal property), "the direction, in any will or deed heretofore or hereafter attested, executed or delivered, for such accumulation shall be for a longer time than during the minority of the persons intended to be benefited thereby, or for a longer time than 33 years from the death of the maker of any will, it shall be void as to the time beyond such minority or said 33 years; and all directions for the accumulation of the rents and profits of real estate or of the profits or income of personal estate, except such as are herein allowed, shall be void."

Specification of Errors to Be Urged.

THE COURT OF APPEALS ERRED:

I. In retroactively changing the depletion rate used by the respondent for some 20 years, when neither petitioner nor respondent "ascertained * * * as the result of operations or development work prior to the close of the taxable year" that any change in the tonnage estimates should be made.

II. In treating the valuation placed on petitioner's iron ore lands in the Federal estate tax proceedings of her father's estate (in which she took no part) as equivalent to an arm's length sale, thus constituting strong if not conclusive evidence of value on that date against the petitioner, whereas in fact this valuation created merely a rebuttable presumption, which should

have been disregarded entirely when petitioner offered substantial evidence on the question.

III. In taxing to petitioner that portion of the iron ore royalties which was irrevocably transferred to a separate trust (a separate taxable entity) by the same compromise agreement under which the remaining portion of the iron ore royalties was transferred to the petitioner.

IV. In retroactively disallowing petitioner's charitable contributions in the years 1939-1941, on account of a 1947 court decision.

REASONS FOR GRANTING THE WRIT.

I.

Taxpayer's depletion allowance should not be retroactively reduced.

Even if it were assumed that the estate tax valuation was correct (see II, *infra*) there seems to be no basis for retroactively changing in any of the years 1938 to 1941 the previously fixed depletion rate uniformly applied in fixing petitioner's income tax liability from 1919 to 1937. The decision below upholding this retrospective change is in conflict with the decision of the Court of Appeals for the Fifth Circuit in *Petit Anse Co.* v. *Commissioner,* 155 F. 2d 797, certiorari denied, 329 U. S. 732, despite the attempt made below to distinguish the latter case.

In both cases, the taxpayer's property had been valued many years before (in *Petit Anse,* on March 1,

1913) and the depletion rate had been fixed on the basis of the tonnage estimate then made. In both cases, the audit of the taxpayers' returns had been delayed for many years for other reasons. In both cases, by the time of the Tax Court's decision, it was evident that the recoverable units of the mineral involved (which was salt in *Petit Anse*) was much greater than the estate tax estimate. In the present case, the original estimate was found by the Tax Court to be about *two-thirds* of the correct amounts for the taxable years; in the *Petit Anse* case, about *one-sixth*. In petitioner's case, her expert witness testified (222a, 223a, 294a, 295a, 298a; Ex. 33) that the increased tonnage could and should have been included in the original estimate, and was *not* the "result of operations or development work" subsequent to that date, as the Statute and Regulations (*supra*) require for a change of rate without a change of basis; in *Petit Anse*, the taxpayer's expert testified that the six-fold increase was ascertainable as of 1931 (six years before the first tax year there involved), and was the result of operations and development work subsequent to the valuation date (as the Tax Court there found).

In all the above respects, it seems obvious that the taxpayer's case here is stronger than in *Petit Anse*.

The Court of Appeals in *Petit Anse* said:

> "We interpret this statute to mean that the revision for depletion *when discovered* as a result of operations or development work will be only as to the allowance for depletion in subsequent taxable years, and that there would be no retroactive revision of the depletion allowance for the

years before the discovery of the existence of recoverable units in excess of the prior estimate.

"The statutes provide that the prior estimate shall be revised and the allowance '*for subsequent taxable years* shall be based upon such revised estimate.'

* * * *

"The Judge of the Tax Court—it being a one-judge decision—was evidently not aware that under the law such a revision of the depletion schedule would be prospective only and applicable only to salt taken in subsequent years. We think that this was a clear cut mistake of law.

"Counsel for the Commissioner, however, undertake to support the decision on the theory that it was a factual finding. They argue that the taxpayer must have learned before the tax years in question of the later estimate by the engineer of its lessee of the additional amount of economically recoverable units of salt in the mine, and having discovered the existence of salt greatly in excess of the previous estimate before the tax years in question, the revision of the depletion allowance should occur as of the time of the discovery of such excess in the course of operations. There are two answers to this contention, viz: (1) There is no evidence to support a finding that the taxpayer had discovered it before the tax years, or at any time before trial; and (2) The Judge of the Tax Court never undertook to make any such finding."

The *Petit Anse* opinion relies on *McCahill* v. *Helvering* (C. A. 8th), 75 F. 2d 725, which held that an expert's upward revision of iron ore tonnage in 1932, though based only on facts known on the 1922 basic

date, could not justify changing 1928 and 1929 depletion.

The memorandum decision of the Tax Court in *Tressler Coal Mining Co.* v. *Commissioner*, 7 T. C. M. 941, follows the *Petit Anse* rule.

Judge Van Fossan apparently attempted to overcome the above ground of reversal by making a finding of fact (49a) that "prior to 1938 petitioner knew that the ore reserves were greater than indicated by the prior estimates." In the first place, this finding omits the essential requirement of I. R. C. 23(m) that to justify change in the depletion rate without a change in basis, the revision must be the "result of operations or of development work" subsequent to the date of the prior estimate. The Tax Court in *Petit Anse, supra,* made just such a finding and in that case the testimony of the petitioner's expert supported the finding. The Tax Court's failure to make that finding here is eloquent of the absence of any evidence to support it.

On the other hand, the Tax Court here supplied the missing finding pointed out in *Petit Anse* as to the taxpayer's knowledge, but only by charging this New York resident with notice of the annual Minnesota tonnage estimates, which the Court treated as "public records" binding on her. There is no evidence whatever that the petitioner ever had actual knowledge of any of these annual estimates. Nor is there any basis in the record to support the Court's erroneous impression that these estimates "were accepted and used in the industry." They were specially prepared for the limited purpose of fixing the lessee's Minnesota property taxes, and in 1919 omitted over eleven millions of

tons of proven low-grade merchantable ore, as well as all probable or prospective ore.

The Tax Court mentions (56a) that in *Petit Anse* it was only at the trial that the respondent learned of the increased estimate, and claimed a lower depletion rate; but apparently does not urge that this could affect the result. It tries to distinguish the cases solely on its own statement (57a) that "the record in the *Petit Anse* case shows that the witness, from whom came the evidence of greater reserves, surprised both parties by his testimony based on facts which the witness had uncovered only a month before the hearing"; and that there was no evidence in that case of "a system of an estimate of reserves for purposes of a State tax, which estimate was a matter of public knowledge" and was "accepted and used in the industry".

Actually, the Tax Court's opinion in *Petit Anse, supra,* 3 T. C. M. 1183, shows that the taxpayer's expert there had been the salt mine lessee's assistant manager and manager on the ground since 1929, and the record on appeal in that case (at p. 83) showed that the taxpayer's president had lived near the salt mines and been personally closely connected with them all his life. Thus here again it seems that far from being distinguishable from *Petit Anse* on the issue of the taxpayer's supposed knowledge of increased tonnage, the present case is stronger for the taxpayer on this point also. For here the taxpayer was living in New York State, and was merely the passive recipient of royalties from the lessee in far-away Minnesota.

The reliance of the Tax Court on the accuracy of the Minnesota tax estimates is quite at variance with the facts (pp. 9-11, *supra*). Furthermore, the respondent in his brief in the Court of Appeals (pp. 31, 32, 35) in effect conceded (as he was obliged to do) that the lease extension agreement of January 1, 1926, in which the lessee agreed to pay a minimum royalty of $687,500 annually at 25 cents a ton till 1950, showed that the lessee then knew that there were then at least 66 million tons on the property (that being the aggregate of 2¾ million tons annually for 24 years). It is true that immediately afterwards he made the apparently inconsistent statement that "the lessee's knowledge as to estimated tonnage" is shown by its contemporary State tax estimate, listed in his footnote 7 as only 54,304,543 tons.* But of course this *tax* estimate excluded all low-grade ore of between 49% and 55% iron content (which was merchantable ore under the petitioner's lease) which averaged eleven million tons in 1919 and 1923, and if (as must be assumed) of approximately the same amount in 1926, would bring the total ore estimate to over 65 million tons, very near the 66 million figure which respondent's brief had previously in effect conceded. And any ambiguity in the concession was cleared away when respondent further argued at page 35 of his brief below that "the execution of that agreement" of January 1, 1926 "should have been an occasion for discovery by her that the amount of recoverable ore was greater than estimated in 1919;" for since the lease extension agreement made no reference whatever to any State tax estimates, the only basis on which the petitioner could have ascer-

* This footnote overstated the shipments between March 2, 1919 and January 1, 1926, by over a million tons, due to erroneous inclusion of the 1926 shipments.

tained any particular tonnage estimate therefrom was that the lessee would not agree to pay for a minimum of 66 million tons of ore unless it were convinced that at least that much ore was available.

This case is extraordinary, if not unique, in that after such a vital concession of error by the respondent, the Court of Appeals affirmed *on the opinion below*.

If, as necessarily follows from respondent's argument, the petitioner knew in 1926 that there were at least 66 million tons then in sight, and if she also is to be charged with notice of the 1926 *property tax* estimate, showing over eleven million tons less, as well as of subsequent similar estimates, she must certainly have assumed (as the record shows to be the fact) that these *tax* estimates were made for a special purpose having little relationship to the total amount of merchantable ore on her land.

The Tax Court seemed on the contrary to be under the misapprehension that the taxpayer's claim (see II, *infra*) that the 1919 tonnage was far greater than the 1919 *property tax* estimate (and the similar estimates for 1938-1941) was in some way inconsistent with the claim that little or no new tonnage had been "ascertained as a result of operations or development work" between 1919 and 1941. Indeed, in referring to the statute to prove this supposed inconsistency (57a), the Court unaccountably replaces with asterisks the crucial restrictive clause quoted in the preceding sentence, making the statute read "the recoverable units were greater * * * than the prior estimate

thereof." Actually, the wording is (I. R. C., sec. 23(m)):

> "In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate."

From the above observations of the Tax Court, it would seem that its failure to find (as it did in *Petit Anse, supra*) that the ascertainment of additional tonnage was made *as a result of operations and development work* subsequent to the prior estimate, was not merely inadvertent, but reflected the Court's feeling that in this case, such a finding would be clearly impossible. We respectfully submit that the absence of this essential statutory requirement precludes any such revision of the depletion *rate* (without change of the depletion *basis*) as the Courts below have imposed.

There seems to be no basis for condemning this taxpayer to the involuntary ascertainment of a fact which she denies. As a New York resident receiving a minimum guaranteed rental from her Minnesota properties, she had no concern with the taxes imposed upon her lessee by the State of Minnesota, and it seems an unwarranted inference that she paid any attention to them, or to the limited tonnage estimates on which they were based. On the contrary, she regularly claimed depletion in her income tax returns upon the basis fixed by the Commissioner from the

beginning. Had she employed Millman to advise her in 1938 it is clear that she would have been told that the State tax estimates were wholly inadequate. This opinion would have been strongly fortified by the price paid by the lessee in 1926, evidently based on a much higher estimate than the contemporary State figure; and also by the failure of the Commissioner to change the depletion rate, though under the 1932 Revenue Act, and by his own regulations as far back as 1921, he should have done so had he considered the State special-purpose tax estimates completely accurate, since these show additional tonnage beginning with 1920.

It is inconceivable that the Commissioner would have stood idly by for over twenty years, making no reduction in the agreed depletion rate, had he throughout this period considered the State estimates as having the sacrosanct finality which he and the Courts below now claim for them. On the contrary, in determining all March 1, 1913 tonnages in Minnesota, he evidently corrected the 1913 State figure by using the latest available estimate (401a), and the only reasonable assumption seems to be that he adopted the same course with taxpayer's depletion until the issuance of the deficiency notice herein. In *Petit Anse, supra,* the Commissioner attempted by retroactive "ascertainment" in 1940 to reduce depletion for the year 1930 which happened to be still open because of another issue. The same injustice would be done to the taxpayer here by reducing depletion deductions retroactively for earlier years which were kept open for other reasons.

Even if it were conceded for the sake of argument that these arbitrarily restricted estimates are entitled

to some weight, as showing fully developed high grade ore, it is certain that they should be only one factor among many in estimating the tonnage of merchantable ore on the Burt lease, and calculating the allowable depletion. It seems clear that the taxpayer never ascertained any increased tonnage during the years here in question, and could not have done so on the basis of post-1919 discoveries; and equally clear that the Commissioner made no such ascertainment until long after 1941.

The "ascertainment" required by the Revenue Act calls for a subjective test. It must be made, as the regulations recognize, either by the taxpayer or by the Commissioner. No other person is authorized to make the determination objectively, nor can the Courts do so. *Petit Anse* v. *Commissioner, supra; McCahill* v. *Helvering, supra.*

While we believe that there was no basis at any time for the Commissioner to dilute the taxpayer's depletion rate by an increased tonnage estimate, based on "operations or development work" subsequent to March 2, 1919, we submit that in any event a "revision" which was not begun till 1943 or completed till 1948 could not apply to the years 1938-1941 here in question, and accordingly the previously fixed rate of depletion must be allowed for these years.

The decision below should be reviewed not only because it is in direct conflict with *Petit Anse Co.* v. *Commissioner, supra,* and with *McCahill* v. *Helvering, supra,* but also because it is in opposition to the important principle of the annual determination of

income, most recently laid down by this Court in *United States* v. *Lewis,* 340 U. S. 590, rehearing denied 341 U. S. 923.

II.

The Courts below adopted an erroneous criterion of value.

While value is in general a question of fact, and as such would not *per se* justify the granting of a writ or certiorari, the opinion of the Tax Court (adopted by the Court of Appeals) clearly indicates that the erroneous value of the leased ore lands was here arrived at by the use of an improper criterion, thus raising a pure question of law. *Powers* v. *Commissioner,* 312 U. S. 359. The Courts below have treated the valuation placed on these leased mining lands by the respondent in fixing the tax upon the estate of petitioner's father, as "tantamount to an arm's length transaction" (53a), in which the estate was treated as the buyer, interested in as low an estimate as possible, and the respondent as the seller, interested in the highest possible value. If this criterion were correct, the result below would necessarily follow, for everyone recognizes that an arm's length sale of property is the best evidence of value.

That this criterion (which we submit is not only novel but erroneous) was the sole basis for the holding below appears not only from the undisputed facts in the record, but even more clearly from the following extraordinary if not unprecedented circumstance, referred to also *supra* at page 23. The only *factual*

basis for the Tax Court's decision—apart from the estate tax valuation—was that the lessee's annual tonnage estimates for State *ad valorem* tax purposes represented the lessee's *bona fide* estimate of all merchantable iron ore on the Burt lease. The respondent in his brief before the Court of Appeals (pp. 31, 32 and 35) in effect conceded that this assumption was unfounded. Yet the Court of Appeals affirmed *on the opinion of the Tax Court.* The only possible explanation seems to be that the Court of Appeals considered the estate tax valuation as sufficient proof *per se.*

Respondent's concession of error was made in a discussion of the effect of the lease extension agreement of January 1, 1926, at pages 30-32 of respondent's brief below. This extension agreement, executed when all relevant factors of value were no more favorable than on the basic date, lifted the annual minimum royalty from $50,000 to $687,500 for the period ending January 1, 1950. Respondent said at page 31 of his Court of Appeals brief: "What the extension agreement did was to give the lessee more time to mine the ore which had been estimated to be contained in the Burt lands;" and again (*ibid.*) "the significance of the lease extension agreement to the lessee was that the lessee obtained additional time in which to mine the ore which it had estimated was in the Burt lands." A simple arithmetical calculation shows that $687,500 at 25 cents a ton represents a tonnage of two and three-quarter million a year, and this for the period from January 1, 1926 to January 1, 1950 aggregates 66 million tons.

The damaging effect of this concession was in no way lessened by respondent's following statement

(Br., p. 32, footnote 7) that on the very same date as the extension agreement, the lessee, which on the one hand was agreeing to pay for at least 66 million tons in a *bona fide* arm's length bargain, was on the other simultaneously estimating a tonnage of only 54 million tons (with the result of minimizing its State tax). And respondent later re-emphasized the higher tonnage implicit in the 1926 agreement by repeating (Br., p. 35) that "the execution of that agreement, if nothing prior to that time, should have been an occasion for discovery by her that the amount of recoverable ore was greater than estimated in 1919."

Respondent's repeated concession of the unreliability of the lessee's self-serving tax estimates was no mere inadvertence, but was compelled not only by the undisputed evidence of petitioner's expert, Millman, who had spent two years on the property and (with his assistants) 133½ working days on his estimates (187a, 312a), but by the admissions of respondent's own experts, Anderson and Grimes (who incidentally had never set foot on the property). Millman's testimony established that with respect to the Burt lease, the agreed percentage of iron which made the ore merchantable on this particular property was 49%. This was proved also by the 1919 drilling sheets of the lessee, which were placed in evidence. This was an undisputed fact, not a matter of opinion. Anderson admitted that the tax estimates included only ore above 55% iron content, and he further admitted that the lessee in 1919, while submitting a tax estimate to the State of only 54 million tons, contemporaneously made an estimate of low-grade ore (below 55%) amounting to over 11 million tons (357a). Anderson also admitted (as the Tax Court found—48a) that these estimates of the lessee included only

fully developed and proven ore, and excluded probable and possible ore (338a, 359a). The Treasury Regulations 103, Sec. 19.23(m)-9, *supra*, require that "probable" and "prospective" ore be included in depletion estimates. Anderson also admitted (353a) that he would only have excluded 29,027,976 tons of Millman's estimate of 97,406,924 tons (189a),—in other words, he conceded an estimated tonnage of 68,378,948, fourteen million tons more than the estate tax valuation.

To the petitioner, the low-grade ore between 49% and 55% was just as valuable as the high-grade ore, since she received 25¢ per ton in both cases. That the low-grade ore was "merchantable ore" under the lease is further proved by a comparison of the total ore shipments from 1919 to 1923, with the "low-grade" ore estimates of the lessee in those years. Shipments were 3,367,793 tons for these four years, and the reduction in the "low-grade" estimate was 869,258 tons. Thus over one-quarter of the shipments must have been of "low-grade" ore, as against approximately one-sixth of "low-grade" ore in the lessee's own 1919 estimate.

Thus tonnages in the Burt lease as submitted to the Minnesota State Tax Commission were *not* "estimated by the lessee, Oliver, in accordance with the best engineering and mining practices available," as the Tax Court found; on the contrary, they were arbitrarily limited for tax purposes to fully developed high-grade ore, and did not even pretend to be complete estimates. Further, Anderson did not think he ever used data obtained from neighboring owners in making his estimates (358a). This must again refer to the tax estimates, for certainly the lessee would

not impose any such self-denying ordinance in gathering information for its own operations. This admission merely emphasizes what is quite clear from the record, that the lessee prepared two different estimates, one of proven high-grade ore which it submitted to the State for the primary purpose of fixing its State taxes, and the other, showing much larger tonnage, which it used exclusively for planning its own operations until 1923, when this additional tonnage estimate was first reported to the State Tax Commission, though not taxed (275a, 357a).

Grimes's acquaintance with the properties was limited to his work as an employee of the Treasury Department in estimating the fair value of all the Minnesota iron mining properties as of March 1, 1913. But he admitted that in estimating these values, *the Treasury Department did not use the State tax tonnage estimates of March 1, 1913, but the much larger figures obtained by starting with the latest available estimates (1920 in the case of U. S. Steel), and deducting the 1913-1919 shipments of ore.* The higher figure thus obtained, in his opinion, was a reasonable estimate of developed and probable ore, and produced a substantially correct result, some 25% higher than the contemporary State tax estimates. If this method was correct, the method adopted in the estate tax valuation was obviously wrong, and must have produced an under-estimate.

Finally, the consideration paid by the United States Steel Corporation in 1926 for the lease extension, less than seven years after the basic date, and under practically identical though slightly less favorable conditions, showing a present value of over $10 million dollars (double the estate tax valuation), reached in

what was substantially equivalent to an arm's length sale to the person most qualified in the world to know the real value and the real tonnage of the property, afforded conclusive proof that the latter was grossly erroneous. But the Courts below, engrossed with their novel theory that the estate tax valuation was equivalent to a sale, gave scant consideration to the real arm's length transaction of 1926, and went so far (54a) as to state that the 1926 valuation could only be used "in corroborating the original valuation",—a proposition for which they cited no authority and which seems meaningless here, where the 1926 valuation was concededly made under circumstances in no respect more favorable than in 1919, by the person who as lessee was best qualified in the world to know the value of the ore lands which it had been operating and exploring for more than twenty-five years, and for which it had been negotiating for at least six years.

Far from being merely "corroborative," we submit that the price paid by the United States Steel Corporation in 1926 was the best possible evidence of the value of the property on March 2, 1919.

The undisputed facts, as well as the respondent's own concession, in its brief below, deprived the Minnesota tonnage estimates of any probative force, and showed that they did not even purport to include all the merchantable ore, but were merly an incomplete estimate of fully-developed high-grade ore specially prepared for tax minimization purposes by the lessee, which simultaneously prepared another estimate of fully-developed low-grade ore, aggregating more than eleven million tons, which it did not report

to the State authorities at all in 1919. Accordingly, the only rational explanation for the conclusion reached below must be (as the opinion clearly indicates) that the estate tax valuation conclusively established the "fair market value at the time of acquisition" which is the criterion established by Sec. 113(a)(5) of the Internal Revenue Code.

Far from being practically conclusive evidence of value on the basic date, as it would be if it were equivalent to an arm's length transaction as the Courts below have held, the estate tax valuation in fact merely establishes a rebuttable presumption, which is not evidence at all against this petitioner, who took no part in the estate tax proceedings. As this Court said in *New York Life Ins. Co.* v. *Gamer,* 303 U. S. 161, 171: "The presumption is not evidence and may not be given weight as evidence." And as was held by the Third Circuit Court of Appeals in *Tabor Mfg. Co.* v. *Commissioner,* 34 F. 2d 140, it is doubtful whether the tonnage estimates which were merely incidental to the assessment of a State property tax on a third party were even admissible in evidence against the petitioner. The Court then said:

> "The only attempted proof was the assessment made by the city of Philadelphia for taxation purposes. No witnesses were called to support such Municipal valuation, or to show any facts whatever in support thereof. As between the present taxpayer and the government, such assessment was not competent evidence to determine value."

It is true that here the respondent produced two experts (neither of whom had ever seen the Burt

properties) as in a sense oath-helpers for the estimates. But one of them, Anderson, admitted that these estimates did not even purport to be complete estimates of all the fully-proved merchantable ore under the terms of petitioner's lease, including no ore under 55% of iron content, whereas the lessee contemporaneously for its own purposes made another estimate of over eleven million tons of ore under 55%; he also did not attempt to lower the 1919 tonnage estimate of the petitioner's expert below 68,378,948 tons (353a); while the other, Grimes, conceded that in all its March 1, 1913 valuations of Minnesota mines, the Treasury Department fixed values averaging 25% higher than those based on the March 1, 1913 State tax estimates. If the Third Circuit Court of Appeals correctly stated the law in *Tabor Mfg. Co.* v. *Commissioner, supra,* and if these State tax estimates, if unexplained and unsupported by testimony, would not be admissible in evidence against the petitioner here, it seems to follow *a fortiori* that the tax estimates should not be considered evidence when the expert testimony in the record affirmatively proves their inadequacy.

The Tax Court's opinion was not written by Judge Black, who tried the case. Accordingly, it lacks any additional weight that might accrue to it from personal observation of witnesses and similar advantages which a trial judge is supposed to enjoy over an appellate tribunal. But the criterion of value adopted here relieved the Courts below of the necessity of giving serious attention to any evidence beyond the bare estate tax valuation.

The Tax Court had in a number of previous cases stated and given effect to what we submit is the correct rule, that in determining gain or loss on the subsequent sale of inherited property, the previously determined estate tax valuation makes merely a *prima facie* case. *Davenport,* 6 T. C. 62 (Acq.); *Augustus,* 40 B. T. A. 1201 (Acq.). In other words, the taxpayer has his normal burden of proof. That this is the limit of the effect of the prior determination sufficiently appears from the fact that the Internal Revenue Code specifically provides that the basis in such cases shall be "the fair market value of such property at the time of such acquisition." The Treasury Regulation above quoted, making the estate tax valuation *prima facie* controlling, is evidently an administrative rule for the guidance of the officials of the Bureau of Internal Revenue. It is like the provision in Reg. 103, Sec. 19.23(m)-8, prohibiting revaluation of mining properties except in case "of misrepresentation or fraud or gross error as to any facts known on the date as of which the valuation was made," and then only "with the written approval of the Commissioner," which was held in *Cape Henry Syndicate,* 30 B. T. A. 794, to have no application or binding force in a Board appeal. Any attempt by regulation to force the taxpayer to prove the essential statutory fact by more than a mere preponderance of evidence would seem an unauthorized change in the statutory meaning, and hence clearly invalid. *Manhattan General Equipment Co.* v. *Commissioner,* 297 U. S. 129, 134; *Lincoln Electric Co. Profit-Sharing Trust* v. *Commissioner* (C. A. 6th), 190 F. 2d 326. Where Congress wishes to provide for anything more than the usual burden of proof it has expressed its intention clearly,—*e. g.,* Sec. 121 (f) of the Revenue Act of 1951, providing

for the disallowance of a certain credit "unless such transferee corporation shall establish by the clear preponderance of the evidence that the securing of such exemption credit was not a major purpose of such transfer."

In another line of decisions, however, the Tax Court (erroneously, we believe) placed upon the taxpayer the additional burden of proving the estate tax value wrong by *convincing* evidence.

The first case in which the "convincing evidence" test was mentioned by the Board was *Williams,* 15 B. T. A. 227. As authority it cited *Bray,* 4 B. T. A. 42, but in that case no evidence at all was offered, and the opinion made no mention of the word "convincing." The Board's *Williams* decision was affirmed by a two-to-one decision of the Eighth Circuit Court of Appeals (44 F. 2d 467). The majority held that there was substantial evidence to support the finding of value (under the then prevailing Dobson rule), and, unlike the dissenting judge, apparently considered mere surplusage the statement in the Board's opinion that "This finding" (of value) "we are bound to approve, unless the presumption in favor of its correctness is overcome by convincing proof presented by the petitioner."

McConnell, 29 B. T. A. 32, 34, and *Northport Shores, Inc. et al.,* 31 B. T. A. 1013, 1017, likewise referred to the necessity for "convincing evidence" to change the estate tax valuation. In *Evans,* 29 B. T. A. 710, 716, the opinion said: "Such valuations" while not conclusive "are evidence that must be overcome by the taxpayer" and the headnote in that case states that this must be done "by convincing evidence." *Larson*

Estate, 3 T. C. M. 481, 485, applies the same test against the Commissioner.

There seems to be no doubt that the requirement of "convincing proof" goes further than a mere preponderance of evidence. We submit that the latter is the correct criterion.

However, the present case goes far beyond the "convincing evidence" test, and in effect makes the *prima facie* presumption wholly conclusive. For the opinion (53a) describes "the estimate adopted by the estate and respondent" in the previous estate tax determination as "tantamount to an arm's length transaction," in which the estate is apparently treated as the purchaser and the respondent as the seller. Obviously, if the estate tax valuation were in fact equivalent to an arm's length sale of the property on the date of death, all other evidence of value on that date would seem of no importance. This would be in accordance with the assumption in *Currier*, 7 T. C. 980, 984, that the figure at which the property was returned for estate tax purposes, "is recognized as the equivalent (Regulations 103, Sec. 19.113(a)(5))" to fair market value at the date of decedent's death.

In fact, nothing could be further from the truth than the theory that an estate tax valuation is equivalent to the price agreed upon between a willing buyer and a willing seller, which is the usual definition of fair market value. This would certainly be the first arm's length transaction in history in which the buyer's opening suggestion as to ore content was accepted by the seller without adding *a single ton* to the buyer's initial estimate of over *54 million tons*; and yet this obliging immediate acceptance is advanced

in the opinion below as its first reason for treating the transaction as an arm's length bargain. Actually, where as here the petitioner was in no sense a party to the proceedings, the estate tax determination, we submit, is not binding on her to the slightest degree and should not be considered as evidence in the case at all, but merely as a presumption which disappears when proof is offered. *Seaside Improvement Co.* v. *Commissioner* (C. A. 2d), 105 F. 2d 990. There in dealing with a 1923 estate tax value and a 1925 condemnation sale the Court said:

> "Once the taxpayer had introduced evidence as to the basic value (the condemnation award and proof that the 1923 and 1925 values were the same) the presumption was out of the case."

The Court will note that in all the above cases in which reference was made to the need for "convincing evidence," the taxpayer had himself participated in the estate tax proceedings, usually as a representative of the estate who swore to the valuation in the estate tax return. In such a case, his statement of value, even though necessarily one of opinion only, might be treated as some evidence against him.

The novel principle of valuation adopted below (which we submit was erroneous) raises a most important question of Federal income tax law which should be settled by this Court. Previously, apart from the comparatively few Tax Court decisions requiring "convincing proof" to change an income tax basis fixed in prior estate tax proceedings, it has been uniformly assumed that taxpayers willing to undertake the usually tedious task of proving value would at least be entitled to their day in court, without bearing more than their usual burden of proof. But if

the newly devised legal fiction that the estate tax value is tantamount to an arm's length sale on the date of death is not reversed, it seems clear that the unfortunate taxpayers will be up against a stone wall, and that they will be generally deterred from even attempting to assert their legal rights by the very heavy expense of preparing for trial in cases of this kind,—a trial which would probably be merely illusory.

While there may be much to say for the certainty and simplicity of the rule enforced below, we respectfully submit that its establishment is properly for the legislative rather than for the judicial branch of the Government. In any event, it represents such a sweeping change in previously well-settled principles of law that the resulting confusion should be resolved by this Court.

III.

That part of the royalties irrevocably assigned to a separate trust was not taxable to petitioner.

Petitioner's position (based wholly on undisputed documentary evidence) may be simply stated as follows:

The compromise agreement provided that the will should be probated as thereby modified, and the estate distributed as if the will "had contained provisions having the legal effect of so modifying it." The will was so probated in Michigan, and in Minnesota, where the leased land was situated. The legal effect of the compromise agreement as above stated was precisely in accordance with the law of Minnesota (which

governed the royalty payments), as pronounced in the previous year in *State ex rel. Hilton* v. *Probate Court,* 143 Minn. 77, which held that a will so compromised would be treated even for purposes of the State inheritance tax just as if the original will contained the modifying provisions. Accordingly, the ownership of the royalties here in question, and their taxability, must be determined as if petitioner's father had provided in his will that all estate and inheritance taxes be paid in the first instance by his executors, but that an amount equal to the portion thereof allocated to the Minnesota lands, plus 4% interest on unpaid balances, should be taken from the income of the Minnesota lands in excess of $100,000 a year, in stated annual installments, and paid by his executor-trustee into a separate trust, the income of which should be accumulated and added to principal till the total amount was paid (as events proved, January 1, 1950), after which the income of said trust should be currently paid to the testator's descendants, and the principal ultimately paid to them (at a date for exceeding petitioner's reasonably possible life expectancy). The mere statement of the above facts seems to answer in the negative the question of petitioner's taxability on any part of these payments, irrevocably assigned in such manner as precluded her from ever receiving or controlling them by the very same instrument under which she was entitled to claim ownership of the balance of the royalties.

The reasoning of the Court of Appeals for the District of Columbia in the leading case of *Corbett Investment Co.* v. *Helvering,* 75 F. 2d 525, squarely supports the petitioner's position, and is in direct conflict with the Courts below. In that case, the testator

left to his widow in 1903 "the annual sum of $12,000 for her natural life, to be paid monthly out of the 'income and rents' from the testator's real property;" and to his three grandsons his entire residuary estate, subject to the widow's charge on the rents. In 1912, the widow released her charge on the rents in exchange for the grandson's joint personal obligation to pay her the $12,000 annual amount. The Court of Appeals said (at pp. 526, 527):

> "It is undoubtedly true that the monthly payment to the widow was secured by a charge upon the rents from the real property owned by the elder Corbett at the time of his death, and it is equally true that until that charge was waived or released, the payments to the widow were not income taxable to the executors of the estate. And this is true because the revenue statutes do not undertake to tax the person who receives income where he receives it wholly as an instrumentality or agency for delivery to another. But in the view we take of the case, the conditions we have just described ended in 1912. In that year the widow agreed on her part to release both the estate and the executors from any and all claims she had on account of the provisions in the will in her favor, and the grandsons, as residuary devisees, agreed jointly to pay her a sum of $1,000 monthly. This release of her equitable lien by the widow was declared by decree of the probate court to discharge and extinguish the right created in her favor through her husband's will, to receive monthly the sum of $1,000 from and out of the rents from the real property.
> * * *
>
> "In this case, from the time of the transfer

> of the real estate to petitioner from the grandsons, petitioner received all the rents in its own right and, so far as we are told by anything in the record, it had the right and the power to use them without accountability to the widow or any one else, and the widow's only right was to demand and receive from petitioner a thousand dollars monthly, regardless of the source from which it came. The payments to her, therefore, were clearly taxable to petitioner, even though they were also taxable to her."

Here the petitioner was not even "an instrumentality or agency for delivery to another" of the royalties payable to the separate trust, for these royalties were paid directly to the separate trust (which was taxable on them) and she never even for a second had the right to touch them. Here also, there was no subsequent release of the rent charge by the widow as in the *Corbett* case, but on the contrary the charge upon the royalties (and also upon the Minnesota lands themselves), which was created by the same instrument—the compromise agreement—under which the petitioner acquired her own interest therein, remained in full force and effect throughout all the taxable years here involved, and thereafter until discharged by payment to the designated separate taxpayer on January 1, 1950.

The *Corbett* case was followed in *Laughlin Estate,* 8 T. C. 33 (Acq.), reversed on another ground (C. A. 9th), 167 F. 2d 828.

The case of *Malloy,* 5 T. C. 1112 (Acq.), upholds the same principle. There decedent bequeathed to his son their partnership business, subject to the pay-

ment of $250 monthly to his widow (not exceeding one-half the net profits). The Tax Court held the son not taxable on the one-half paid to testator's widow, saying (at p. 1116):

> "Petitioner Frank R. Malloy acquired the business not by purchase, but by bequest, and he took only what the testator's will gave him. The payments to the widow were not the personal obligations of the petitioners. They were but a conduit or at best agents for the payment to the widow of the bequest to her. If the testator chose to give his son something less than all his interest in the business and to give his wife a part of it, that was his privilege. In effect, that is what he did. The bequest to testator's wife and the income from his share of the partnership property were completely interdependent. In substance, the bequest was a portion of the net income from that particular property, which, in equity, would ordinarily be treated as giving her an interest—a sort of life estate—in the property itself."

The *Malloy* case was recently cited with approval in *Collins,* 14 T. C. 301 (Acq.).

The holding in *Driscoll,* 3 T. C. 494, is closely pertinent to the present case. There the Tax Court said (pp. 496-497):

> "It is the petitioner's contention that, since she did not, according to the express terms of her assignment, assume or agree to pay the indebtedness, but took the property subject to the encumbrance of the mortgage and the assignment of the oil, she is not taxable on the payments made

on the indebtedness, which was at all times the legal obligation of some other person.

"We think the petitioner's position is impregnable. In acquiring the interest in the lease, subject to the mortgage and the assignment, she acquired no interest whatever in the oil which produced the income here in dispute. That oil had been validly assigned before she acquired her interest in the lease. The oil to which she was entitled under her assignment was the oil to be produced after the obligation to the bank was fully satisfied. Until that time, she was not entitled to any oil produced from the premises in question, or its proceeds. She never received the income, nor any benefit from it. It was not at her disposal or subject to her dominion or control. She could not successfully have demanded its payment to her. The indebtedness upon which it was applied was not incurred by her, nor was it ever assumed by her as a personal liability."

Presumably neither the respondent nor the Courts below would have thought of taxing these assigned royalties to the petitioner if the compromise agreement and the mortgage, in 1920, and the lease extension agreement and the February 8th letter in 1926, had not used throughout the words "indebtedness," "loan," "principal" and "interest," to describe the assignment of part of the royalties to a separate trust. But the tax results of the transaction must be judged by its true nature, rather than by the descriptive words used by the parties. As was pointed out in *St. Louis Trust Co.*, 40 B. T. A. 165, 176 (Acq.), the so-called "interest" adjustments in the will there in-

volved, to equalize advances among beneficiaries, were merely means of determining income allocation, as is true here also. Where "there was no unconditional promise on the part of the bank to pay the contribution or any part of it at any time in the future," the Tax Court held in *Feathers,* 8 T. C. 376, 382, "clearly there is no basis here for a bad debt deduction."

Apart from the specific exculpatory statement quoted *supra* (pp. 14-15), the compromise agreement here completely contradicts a debtor-creditor relationship. First, there was no obligation outside the compromise agreement on petitioner and her co-heirs to pay any part of the Federal estate tax, Minnesota having no apportionment statute (see *Riggs* v. *Del Drago,* 317 U. S. 95). Second, the compromise agreement imposed no personal obligation on petitioner and her co-heirs to pay anything whatever: the payments were to be made solely from the proceeds of the Minnesota lands, and none were to be made till after $100,000 a year was paid to petitioner and her co-heirs. The third feature distinguishing this transaction from a true loan is that while the taxes were paid by the Second National Bank of Saginaw, as executor-trustee of W. R. Burt's estate, "repayment" was made to the Bank as trustee of an entirely different trust from the residuary trust under W. R. Burt's will. Of course, as executor-trustee under the will, the Bank would have no possible right to "lend" the trust funds to any one unless the "loaned" funds were to be restored to the same source from which they originated. The fact that here they were irrevocably assigned in the same instrument to an entirely different trust (though the trustee was the same) proves conclusively that the transaction was not a "loan" at all.

Even if (contrary to fact) petitioner and her family had actually borrowed the money from a bank to pay taxes for which they were primarily liable, so that they really owed the money, and had then persuaded the bank to accept in settlement of the debt the arrangement set forth in the compromise agreement, the Tax Court has held that any income thereafter accruing to the assignee bank would not be taxable to the former debtor. *Delacroix Corporation*, 13 T. C. 827. There the taxpayer corporation owed two banks $132,365.39, and on October 3, 1938 executed two instruments, one a so-called promissory note in that amount, with 8% interest, but the whole payable only out of oil royalties, and the other an agreement to assign oil royalties to further secure payment of the so-called note, which assignment was to become void on payment of the so-called note in full as to principal and interest. The Tax Court held that the effect was to cancel the debt, and to require the banks to look for recovery solely to the royalties; and accordingly that the taxpayer could not accrue interest any longer on the cancelled debt, but that the banks, rather than taxpayer, were taxable on the assigned royalties. To make the point even clearer, the Tax Court held, on the other hand, that since another assignment of royalties in that case was made only as additional security, the taxpayer remaining also liable for the debt so secured, it was taxable on these royalties, since they were applied for its benefit to discharge its continuing debt.

The learned Courts below held that petitioner's view that there was no personal obligation on the heirs to pay anything "is without merit." In view of the undisputed facts, we cannot understand the quoted

phrase to connote a holding that there *was* any personal obligation on petitioner's part. For the 1920 agreements expressly negatived any such personal obligation, the form of mortgage specifically providing that the obligation of petitioner and her co-heirs "with respect to said bond, or to the indebtedness (both principal and interest) evidenced by it is to be limited to said royalties or to the proceeds of the sale of said lands and the ore therein, in the event of a sale thereof." See pages 12-15, *supra.* And the concluding paragraphs of the final order of the Probate Court in 1922, pursuant to the compromise agreement, quoted in the opinion below (33a-34a), conveyed the ore lands to the petitioner and her co-heirs "without prejudice, however, to any lawful conveyance of said property, or any part thereof, or any interest therein or lien thereon, or any assignment of any income, royalty, or profit therefrom by said persons or any of said persons made, more specifically set forth in that certain indenture recorded in the office of the Register of Deeds of St. Louis County, Minnesota, in Book 442 of Mortgages, on pages 34 *et seq.*"—bringing this case precisely in accord with the situation in *Corbett Investment Co.* v. *Helvering, supra,* before the widow in that case released her lien on the rents.

Presumably the Courts below felt that the absence of personal liability on petitioner's part was immaterial, because of the "patent purpose and method in the advance and repayment" of the taxes here involved, which the opinion describes as nothing "more or less" than a loan repayable out of the royalties. This seems the only rational explanation of the references in the findings of fact (35a-37a) to the recitals in the lease extension agreement of January 1, 1926

and letter agreement of February 8, 1926, which repeat the loose language of the compromise agreement in describing the charge on the royalties as an "indebtedness" of the heirs. This loose use of language is compounded in the lease extension agreement by the reference therein to the $300,000 payment by the lessee to the trustee as a "loan," for it seems obvious from reading the quoted provision (36a) that this also was in no respect a loan in legal contemplation, but an advance royalty, there being no obligation ever to repay it to the lessee except in reduction of future royalties. And the opinion below so concedes at page 49a, describing this payment as "an advance payment of royalties in the amount of $300,000 which was to be repaid by the lessee withholding approximately $15,000 from each year's royalty payment." The use of the word "repaid" here seems as much an example of loose terminology as the parties to the compromise were guilty of.

The Courts below could hardly have imagined that the heirs, not being obligated personally under the 1920 agreements, would have so casually and unnecessarily assumed a personal obligation of $1,356,400 six years later; and the 1926 letter is not susceptible of any such interpretation. The initial reference therein to the "contract of July 1, 1920," indicates beyond question that the parties' expressions were to be read within the framework of the compromise agreement, and were not intended to subject the heirs suddenly to a new personal liability. The somewhat loose language of the 1926 letter perhaps originated in the imprecise use of the word "indebtedness" in the compromise agreement, but "the patent purpose and method" of that agreement was to restrict any possible collection of funds for the new trust to the lands

themselves, and then only after the heirs (whom the Courts below treated as if they owed $1,356,400) had received from these lands $100,000 a year, free and clear of any charge whatever. And the final sentence of the 1926 letter (not quoted in the opinion below) expressly confirms "the provisions of the Contract of July 1, 1920, relative to the payment of $100,000 to the heirs out of each year's royalties before applying same on the debt hereinbefore referred to,"—provisions inconsistent with the existence of any "debt" in the legal sense, and emphasizing that the charge on the royalties was only a second lien.

The Courts below must have felt that because of the references throughout the 1920 agreement (reiterated in 1926) to a "loan" and a "debt," the petitioner should be taken at her word, and taxed as if she were in fact a debtor. But while she or her representatives may be subject to criticism for this inartistic description of the charge on her lands, the taxes imposed by the Courts below seem much too onerous a punishment for this careless phraseology. Far from contemplating an ordinary loan involving the borrower's personal responsibility and unconditionally repayable to the lender, the compromise agreement merely carved out a portion of the ore royalties to be accumulated in a separate trust, the income of which the heirs and their issue would begin to receive in less than thirty years, whereas the income of the main trust—the fictitious "lender" who could never be repaid a nickel—was accumulated for a hundred years. The Courts below seem to have invented a loan with neither a debtor nor a creditor, but surely there is no place either in law or in the practical matter of taxation for such an anomaly.

The opinion below expresses needless alarm (65a) over the possibility that such an arrangement as this compromise agreement (which certainly had no relation to intentional tax avoidance) might deprive the government of the entire benefit of estate tax revenues. On the contrary, the petitioner's position here would not deprive the government of any taxes whatever. It would merely require the separate trust, already taxed on the so-called "interest" assigned to it from the royalties, to pay income tax also on the so-called "principal" payments likewise irrevocably assigned to it, instead of making the petitioner pay tax on the trust's income.

There is no rational basis for taxing to the petitioner these royalties which were irrevocably assigned to a separate taxable entity by the same instrument under which petitioner acquired her interest in the balance of the royalties. And it is impossible to conceive that the same compromise agreement imposed a personal obligation on the heirs to repay and simultaneously relieved them of this obligation; and that the release from this supposed personal indebtedness (which never existed for the smallest fraction of an instant) is a proper basis for imposing income tax on the petitioner for royalties which likewise never belonged to her for even a moment.

The holding below is clearly in conflict with the decision of the Court of Appeals for the District of Columbia in *Corbett Investment Co.* v. *Helvering, supra,* as well as with the Tax Court's decisions in *Malloy, Collins, St. Louis Trust Co.* and *Laughlin Estate, supra,* in all of which the respondent acquiesced, and in *Delacroix Corporation, supra.* The

decision is an unwarranted extension of the doctrine of *Douglas* v. *Willcuts,* 296 U. S. 1, and is in conflict with the principle of *Blair* v. *Commissioner,* 300 U. S. 5.

IV.

The disallowed charitable contributions were deductible.

The Courts below found that the gifts made by the taxpayer in 1939, 1940 and 1941, while concededly believed by the taxpayer to be valuable, were in fact of no value. The chief ground for this holding was that in 1947 the Supreme Court of Michigan held by a 5 to 2 decision that instead of owning 1/6th of the trust of personalty, aggregating some $7,000,000, as she believed and claimed, she had only a remote contingent interest therein; and that the effect of this decision "is retroactive in logic and in consequence" (72a).

This reasoning seems contrary to the principle established in *Ithaca Trust Co.* v. *U. S.,* 279 U. S. 151, that events subsequent to the date of transfer have no bearing on the value transferred, which is the statutory criterion here. In that case decedent's widow, the life tenant, died within six months of his death, before his estate tax return was filed. The Court held notwithstanding that in valuing the charitable remainder, the widow's full life expectancy must be deducted. Mr. Justice Holmes wrote the unanimous opinion, saying (p. 155):

> "Like all values, as the word is used by the law, it depends largely on more or less certain pro-

> phecies of the future; and the value is no less real at that time if later the prophecy turns out false than when it comes out true. See *Lewellyn* v. *Electric Reduction Co.*, 275 U. S. 243, 247. *New York* v. *Sage*, 239 U. S. 57, 61. Tempting as it is to correct uncertain probabilities by the now certain fact, we are of opinion that it cannot be done, but that the value of the wife's life interest must be estimated by the mortality tables."

The decision below also seems to violate the fundamental principle that income taxes must be determined annually, on the basis of facts ascertained by the end of the taxable year. This broad principle was most recently upheld in *United States* v. *Lewis, supra,* where the opinion pointed out (340 U. S. at p. 592) that this Court would not transgress this rule merely on account of the adventitious circumstances that the statute of limitations had not yet run as to the earlier year involved.

It could hardly be contended that a contribution of stock in 1939 could be disallowed because the stock became worthless in 1947.

The ruling below on this issue is in striking contrast to the ruling on the depletion issue, that the value fixed for taxpayer's ore lands on January 1, 1926 was a subsequent fact irrelevant to the valuation of the same property in 1919. In fact, the lessor's and lessee's evaluation in 1926 seems much less a "subsequent fact" than the Michigan Court's 1947 decision. For the 1926 agreement was the best evidence of what the actual predictable tonnage was in 1919, and what the lessee (the best informed pur-

chaser) would have been willing to pay for it then; further, the 1926 transaction was already in contemplation in 1919. We submit that not only was the reasoning below on these two issues inconsistent, but also that it was wrong as to both. For the Michigan decision could only be treated as proof of what the Michigan law was in 1939, on the metaphysical theory that judges merely declare the law, and do not make it. However interesting that theory is, it surely has no place in the eminently practical field of taxation. And it seems obvious here that the seven judges who ultimately ruled on the case in 1947 had never heard of it in 1939, 1940, or 1941.

As against the inchoate, unpredictable and diverse views to be formed years later by the Supreme Court judges, taxpayer in making the gifts relied on the considered written opinion of the recent Chief Judge of Michigan's highest court, that her title was substantially beyond question under the law of that State. He died before he could argue the case in person (318a), but despite this misfortune, the Supreme Court of Michigan kept the case under advisement for a year and three months (317 Mich. 370, 372), during which time additional briefs were requested by the Court (p. 392), before deciding by a vote of five judges to two that the "legal heirs" under the will must be ascertained as of the date of distribution rather than the date of death. Not only the protracted deliberation, but also the length of the two opinions, and the vigor of Judge Reid's dissent, show by what a narrow margin petitioner's well-grounded expectation is finally defeated, more than five years after the close of the last tax year here involved. It is evident from the concluding remark in the later lengthy opinion in *Hay* v. *LeBus*,

317 Mich. 698, 714,—"had appellants succeeded in establishing their contention in the *Hay* case as to who were the heirs at law of Wellington R. Burt, deceased, there would have been little or nothing left for adjudication in the instant case,"—that in that event the gifts herein would have amounted to $20,000 each, less the small contingent fee.

If subsequent events could be taken into account, the Michigan statute which took effect September 13, 1949 (pp. 15-16, *supra*), of which taxpayer was not aware at the time of trial, which voids all accumulations of more than 33 years even if provided in previous instruments, would appear as important as the 1947 court decision. As this Court held in *Demorest* v. *City Bank Farmers Trust Co., Trustee,* 321 U. S. 36, 47, 48, new legal rights are established in the same way by judicial decision and by legislative enactments.

The opinion below (72a) relied on "another reason for sustaining the respondent, *i. e.*, there is no basis in the record by which to fix a value even though a speculative value be indicated." This second ground seems contrary to the leading case of *Cohan* v. *Commissioner* (C. A. 2d), 39 F. 2d 540. The determination of the effect on values of pending title litigation seems peculiarly within the scope of judicial cognizance. See *Champlin Refining Co.* v. *Commissioner* (C. A. 10th), 123 F. 2d 202; *Dickson Estate,* 13 T. C. 318. Had taxpayer's title been clear, the value of her one-sixth interest would have certainly exceeded a million dollars, since the whole trust aggregated some $7,000,000, subject only to annuities worth less than $200,000; while the fact that all the income was accumulated up to final distribution made the gift to

a charity equivalent to the present value of the corpus. It seems that the learned Judges of the Tax Court and the Court of Appeals are the most competent experts upon the probabilities of the outcome of the litigation when the gifts were made. We doubt if any of them would have predicted in 1939, 1940 and 1941 that the chances that petitioner would be sustained in her position (so confidently upheld by Judge Fead) as a "legal heir" of her father, were less than even.

It would have seemed a most uncertain prophecy then that a majority of Michigan's highest court would find (317 Mich. 407), that the aged Mr. Burt, "in postponing the distribution of his large estate sought ultimately to do the greatest good to the greatest number of his descendants," or would see in the weird provisions of his will (which left not one penny to charity) a laudable humanitarian philosophy instead of a self-aggrandizing desire to keep his dead hand firmly on his huge, ever-growing posthumous hoard to the last permissible moment,—even then loath to give it away, but perforce allowing the law to distribute it to his "legal heirs." Until 1947 the respondent was claiming in the gift tax litigation that the gifts were worth more than $20,000 annually (72a).

We respectfully submit that these gifts had value when they were made; that the petitioner proved facts from which this value could be fixed; or at least proved that the respondent's determination was wrong, so that the case should have been remanded to the Tax Court for further proceedings under the doctrine of *Helvering* v. *Taylor,* 293 U. S. 507.

We respectfully submit that the decision below, apparently in conflict with *Ithaca Trust Co.* v. *U. S.* and *U. S.* v. *Lewis, supra,* involves an important question of Federal law that should be reviewed by this Court.

Conclusion.

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be granted.

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May 29, 1952.

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